



State of California
Franchise Tax Board

Audit / Protest / Appeals

(The process)

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Mission of the Franchise Tax Board

The purpose of the Franchise Tax Board is to collect the proper amount of tax revenue, and operate other programs entrusted to us, at the least cost; serve the public by continually improving the quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency and fairness.

Statement of Principles of Tax Administration

The primary function of the Franchise Tax Board is to administer the Revenue and Taxation Code. Tax policy for raising revenue is determined by elected officials.

With this in mind, it is the duty of the Franchise Tax Board to carry out that policy by correctly applying the laws enacted by the Legislature; to determine the reasonable meaning of various Code provisions in light of the legislative purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Franchise Tax Board, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he or she is “protecting the revenue.” The revenue is properly protected only when the true meaning of the statute is ascertained and applied.

The Franchise Tax Board also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised when they have merit, never arbitrarily or for trading purposes. At the same time, employees should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Franchise Tax Board position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

(Introduction)

The primary responsibility for determining the correct amount of tax rests with taxpayers. In accordance with California Revenue and Taxation Code Sections 19501 - 19504, the Franchise Tax Board (FTB) has developed an audit program. The goal of the department is to complete audit cases within two years of initial contact, four years from the date your tax return was filed, or within a reasonable period as dictated by the circumstances of the case.

Purpose of an Audit

The purpose of an audit is to efficiently determine the correct amount of tax based on an analysis of relevant tax statutes, regulations, and case law as applied to the facts of the audit. The procedures and techniques needed to successfully complete an audit assignment will depend on the circumstances in each case. In all cases, established audit objectives and resource considerations govern how the procedures and techniques are utilized, and the manner in which they are applied. Best audit practices has shown that efficient audits are achieved through cooperation, effective communication, and setting and adhering to set timeframes throughout the audit process.

Audit Standards

As recognized professionals, FTB auditors are expected to conduct themselves and their work in a manner that is both fair and effective. Auditors are responsible for correctly applying and administering the tax laws in a reasonable, practical, fair and impartial manner. Audits should be conducted in a reasonable manner within the bounds of the law, with sound administration, minimal delay, courtesy, and respect to taxpayers. To achieve these objectives, auditors should conduct audits in a manner, which is not unnecessarily burdensome, costly, or intrusive to taxpayers. Our goal is to continually strive for quality, effectiveness, and economy in the services provided to taxpayers.





The audit process consists of identifying issues, obtaining, evaluating, and documenting information, and arriving at the correct determination, which is supported by a reasonable interpretation of the tax laws. Audits are to be conducted in adherence with the following audit standards in all cases:

LEGALITY / Audit activities and conclusions must agree with established laws and legal interpretations.

OBJECTIVITY / An objective examination of sufficient, relevant, and available factual data be made in a fair and unbiased manner.

TIMELINESS / Audits must be conducted and completed promptly, with a minimum of inconvenience to taxpayers.

SUPPORTABILITY / Recommendations must be adequately supported, consistent with both the facts and the law.

(Before the Examination)

The pre-audit phase is vital to the audit process. This is the phase where auditors determine whether to proceed with an examination or accept the tax returns as filed. Items reviewed during this phase may include analysis of the federal and state tax returns, prior audit history, large or unusual deductions, public information through the Internet, matching of data with the Internal Revenue Service, etc. If proceeding with an audit, the auditor plans the audit and performs the preliminary work. Proper attention to the pre-audit procedures will improve the quality of the audit and help reduce total audit time and costs.

Desk or Field Audit

Before an examination commences, the auditor assigned to your case must decide whether a desk (i.e., correspondence audit) or field audit will be conducted. A desk audit is an audit conducted primarily through mailed correspondence. In contrast, a field audit is an audit that takes place at the taxpayer's residence, place of business, or some other location that is not an office of the FTB. The auditor will determine if the examination will be a desk or field audit based on the complexity of the tax returns and which type of audit will be more conducive to effective and efficient tax administration. In general, single issues with minimal documentation will be conducted through correspondence, whereas complex tax transactions and large corporate taxpayers typically involve field audits.

Location of Field Audit

A field audit will generally take place at the location where the taxpayer's original books, records, and source documents pertinent to the audit are maintained. In the case of a sole proprietorship or business entity, this will usually be the taxpayer's principal place of business. Field audits can be moved to a FTB office, or your representative's office, if you do not have the appropriate work area available, you do not have time available for the audit to be conducted at your location, or as circumstances warrant.

Designated Representative

If your tax returns are selected for audit, you have the right to have someone represent you during the audit. You can designate a representative (e.g., CPA, EA, Tax Attorney, etc.) by completing a Power of Attorney (FTB Form 3520) and providing the form to the auditor assigned to the case.



(During the Examination)

The following audit procedures may be applied, either in desk or field audits, depending on the nature of the audit. Desk audits typically involve the issuance of an initial contact letter, information document requests, and audit issue presentation sheets. Desk audits may also include an audit plan. Field audits traditionally cover all items discussed below.

Initial Contact Letter

The initial contact letter is the first document used during the audit phase. For correspondence audits, the letter explains that your tax returns have been selected for audit, the issues under examination, and the name of the auditor assigned to the case. For field audits, the letter explains that your tax returns have been selected for audit and asks you to complete an audit questionnaire. Both letters also request the key point of contact (e.g., taxpayer or designated tax representative) and associated telephone number.

Scheduling of Audit Appointment

Audit staff will contact you to determine audit appointments that are conducive to you, but also allow the audit to be completed within designated benchmarks (i.e., two years of initial contact or four years from the date the tax return was filed). Throughout the audit, audit staff will review previously established dates and make any additions, deletions, or adjustments to keep the audit moving towards completion. If a field appointment is needed at a location other than your principal place of business, the scheduling of such appointment should be coordinated with the auditor assigned to the case.

Opening Conference

The purpose of the opening conference is to establish the groundwork necessary to conduct an effective and efficient audit. The opening conference establishes lines of communication and helps build a partnership between all parties involved in the audit. During the opening conference the auditor will introduce the participants of

the audit; agree on a general audit plan; discuss audit processes and procedures; agree upon expected timeframes; and start developing a rapport with the individuals that will be working on the audit. In addition, the auditor will generally have some questions on how you filed your tax returns, the audit issues identified, and any past audit history.

Audit Plan

The audit plan develops the framework of the audit. The audit plan identifies key potential audit issues and is a tool that provides a road map of how the audit began, how the audit is progressing, and where the audit is going. The plan allows the auditor and you to work together to resolve problems as early as possible in the audit process and establish a partnership relationship. The audit plan helps ensure an effective and efficient audit that is less burdensome, less costly, and less intrusive.

Your participation in the development of the audit plan is encouraged. We are receptive to your suggestions of what are we doing well and what can we do to make it better. By incorporating your feedback in the audit plan:

- Both parties will more efficiently manage the fact gathering and analysis process.
- You can anticipate deadlines and provide alternative solutions to resolving issues, such as using alternative documents, or using agreed sampling methods where the records are too voluminous.
- It will alleviate any apprehension you may have about what to expect, and foster communication and cooperation in the audit process.
- Issues to be included in the audit plan will be based on the materiality of the potential adjustment and balanced with the statutory requirement to determine the correct amount of tax.
- Emphasize that the audit plan is a guide for the examination. It is subject to revision as progress indicates the need for more, less, or different work than originally planned.





Information Document Request (IDR)

The purpose of issuing IDRs is to gather the relevant facts necessary to substantiate the audit issues. As a general rule, the response time for an IDR is 30 days from the date the IDR was mailed or hand-delivered to you or your designated tax representative. The written request provides a record of communication between the auditor and you, and helps avoid possible misunderstandings that could result from any verbal discussions. All requests for information should be documented in an IDR. In addition, a Master IDR Log will be maintained to track all issued IDRs and to provide a clear focus for the status of IDRs. Copies of the Master IDR Log should be shared with you so all parties have a common understanding of the items requested, as well as, the items outstanding.

When issuing IDRs, the auditor should discuss the content with you. Audit staff should ensure that you understand what is being requested, and discuss whether the information being requested will resolve the issue or whether alternative information may be necessary. This will eliminate the need for additional IDRs on the same subject. Failure to respond to IDRs does not alleviate the burden of proof from the taxpayer.

Status Conference

The purpose of the status conference is to measure expectations against benchmarks and to expedite the audit process. The status conference is used to keep the communication process between you and the auditor open. Items to consider include:

- Frequency of the status conferences.
- Information Document Requests.
- Audit Issue Presentation Sheets.
- Resolution of any disputes related to the conduct of the Audit.

Audit Issue Presentation Sheet (AIPS)

The purpose of the AIPS is to communicate to you the specific audit issue, the facts developed, the relevant law, and the audit recommendation on the issue. Issuance of the AIPS provides the opportunity to conclude and resolve issues on an ongoing basis. The AIPS is an important tool that keeps you fully informed about the FTB's position on each issue. All audit adjustments should consistently be set forth in an AIPS format.

A Master AIPS Log will be maintained to track all AIPS and to provide a clear focus for all adjustments made. The Master AIPS Log should be updated continuously, with a copy provided to you for your records.

Closing Conference

The closing conference is conducted to discuss any items not already covered in the Status Conferences and to explain the final audit results. It includes an explanation of the review process, the process for issuing any applicable notices, and estimated timeframes so that you are well informed on the closing process. An explanation of how you will be notified of any changes during the review process should also be covered. The closing conference is also an excellent opportunity to obtain feedback on what worked well in the audit process and for obtaining suggestions from you on things that could be improved.

Resolution of Disputes

During the course of the audit, or at the end of the audit, the auditor may propose adjustments through the issuance of Audit Issue Presentation Sheets. If you disagree with any proposed changes, you may contact the auditor's supervisor at any time throughout the audit to express your disagreement with the proposed changes and work at resolving the issue. The audit supervisor will be listed on the audit plan distributed to you at the beginning of the audit.

Any disputes concerning the conduct of the audit should be addressed with you immediately. If the dispute is not resolved between the auditor and the first

line representative, assistance at the next level should be requested. If the audit supervisor, or next level manager identified in the audit plan, is unable to resolve the issue, you have the alternative to request Program Manager or Bureau Director assistance to resolve the case. All avenues of resolution should be explored in order to maintain the quality and integrity of the audit process.

What Happens at the End of the Audit?

At the end of your audit, we will provide you with our findings in writing. We will issue one or more of the following, as applicable:

- A letter stating we accepted the return or the claim for refund as you filed it.
- A letter stating we denied or partially denied your claim for refund.
- A Notice of Proposed Assessment (NPA) indicating the additional tax we believe you owe us.
- A Notice of OverAssessment or a Notice of Proposed OverAssessment indicating the refund we owe you.
- A Notice of Proposed Adjusted Carryover Amount (NPACA) indicating we changed a carryover item but you owe no additional tax.

Audit staff will also inform you of your protest or appeal rights, either through the closing letter or closing conference. For all audit notices, you may protest the audit findings; whereas, with claim for refund actions, you may appeal the audit findings.

(After the Examination)

If we issued a Notice of Proposed Assessment and you agree with the auditor's findings, please pay the additional tax and interest shown on the accompanying notice. Do not submit Form 540X, Amended Individual Income Tax Return, or 100X, Amended Corporate Income Tax Return. Additional interest accrues from the date of the notice to the date we receive your payment. However, we will not charge additional interest if we receive your payment in full within 15 days of the date we mailed the notice. For additional information on how to pay, please refer to FTB's website: http://www.ftb.ca.gov/online/payment_choices.html

(Protest Process)

If you disagree with the audit adjustments on the Notice of Proposed Assessment or the Notice of Proposed Adjusted Carryover Amount, you can file a protest with us within 60 days after the mailing of the notice as prescribed by California Revenue & Taxation Code Section 19041. The notice will also reflect the protest by date along with instructions for filing a protest with the FTB's Protest Section. If you do not file your written protest within the 60-day timeframe, the assessment becomes final and we will bill you for the amount due, including interest and any applicable penalties.

Accrual of Interest

To stop the accrual of additional interest, you may pay the assessment in full within 15 days of the date we mailed the notice. This will stop the further accrual of interest without losing your rights to protest the audit adjustments. However, simply filing a protest will not stop the accrual of interest. For more information about payments treated as cash deposits, get FTB Notice 2005-6 (11/28/05) at www.ftb.ca.gov.



Filing a Protest

Your written protest must clearly state what issues you are protesting and why. Include the following:

- Your name and address.
- Your social security number or taxpayer identification number.
- The amounts and taxable years.
- A statement of facts.
- Your explanation of why our assessment is wrong.
- Points in support of your position, including authority supporting your position (e.g., law references).
- Your signature or your authorized representative's signature.
- Your daytime telephone number (including area code).
- A copy of the notices being protested.
- A completed Power of Attorney Declaration (FTB Form 3520) from your designated representative, if applicable.

Mail your protest to:

PROTEST SECTION
FRANCHISE TAX BOARD
PO BOX 1673
SACRAMENTO CA 95812-1673

Resolving the Protest

The protest process is intended to be informal. It is the first step in the administrative and judicial review process where you can dispute proposed audit adjustments. It provides an opportunity for the hearing officer (i.e., staff member assigned to resolving the protest) and you to discuss the issues involved, to ensure that all of the necessary facts to resolve the protest have been presented, and that a proper interpretation of law is applied to the substantiated facts.

The hearing officer assigned to the case is charged with the responsibility of making a determination of the correct amount of tax based upon the facts and a correct application of the law to you, the taxpayer. The protest process is not a negotiation where disagreements are compromised. There is a separate Administrative Settlement process that allows for taxpayers and the FTB to reach an agreement as to the settlement of a dispute based upon the various risks that are involved. Refer to Revenue and Taxation Code Section 19442 and FTB Notice 2007-2 for more information on the settlement process.

A hearing will be granted if one was requested in the protest letter. You or your authorized representative may attend the hearing to present your position on the audit issues. The hearing is generally conducted at one of the FTB's public service offices closest to you and is scheduled at a mutually convenient date and time.

Once we consider your protest and make a final decision, we will send you a formal notice (i.e., Notice of Action) documenting the findings. If you disagree with the protest determination, you may appeal to the State Board of Equalization within 30 days after the mailing of the Notice of Action.



(Appeals Process)

If you disagree with our determination, you may appeal in writing to the Board of Equalization (BOE) 90 days after the denial, or partial denial of a claim for refund, or 30 days after the mailing of the Notice of Action. The BOE is a separate governmental agency that handles all personal and corporate income tax appeals. For detailed instructions on how to file an appeal, get BOE Publication 81, Franchise and Personal Income Tax Appeals, at www.boe.ca.gov.

When an appeal is filed, both the FTB and you will be given an opportunity to file additional information to support each respective position. The appeal will be set for an oral hearing before the BOE, if you request a hearing.

Once the BOE has evaluated the facts and rendered a decision, the law allows for a rehearing requested by either party within 30 days of the decision. If no rehearing petition is filed, the BOE's decision becomes final 30 days after it is rendered. If a rehearing petition is filed, the BOE's decision on rehearing becomes final 30 days following the decision on the rehearing.

After the Board of Equalization renders a decision, it is final and binding only on the Franchise Tax Board. You may file in the California Superior Court, after a denial by the BOE, by paying the tax and filing a claim for refund. After the California Superior Court has rendered its decision, either party (i.e., FTB or the taxpayer) may file an appeal of the decision to the California Court of Appeal, and in some cases, to the California Supreme Court, and ultimately the United States Supreme Court.

(Taxpayer Advocate Services)

The Taxpayer Advocate's office is available to provide an independent review of your unresolved tax problems. We strive to ensure that your problems are handled promptly and fairly, and that you have the highest confidence in the integrity, efficiency, and fairness of our state tax system.

Your Rights as a California Taxpayer

You have rights as a taxpayer when dealing with the Franchise Tax Board. The sources listed below will provide you with sections of the law and publications that address your rights.

California Taxpayers' Bill of Rights (FTB 4058) / This brochure gives you a basic description of your rights during the audit process. It also tells you how to protest and appeal and describes potential collection actions available to FTB staff.

California Taxpayers' Bill of Rights 2 (FTB 4063) / California generally conformed to the federal legislation enacting Taxpayers' Bill of Rights 2. This brochure provides a brief description of the major provisions of the California legislation.

California Taxpayer Bill of Rights Act of 1999 (FTB 4064) / To further guarantee your rights as state taxpayers, California's lawmakers enacted the Taxpayers' Bill of Rights Act of 1999. This publication provides the major highlights.

California Taxpayers' Bill of Rights - A Comprehensive Guide (FTB 4058C) / This publication describes each provision of the California Taxpayers' Bill of Rights and the California Taxpayers' Bill of Rights 2. It also tells you how FTB has implemented these provisions.

- If you have not been able to resolve a problem in prior contacts with the FTB, or you are suffering a hardship as a result of our action, you can contact Taxpayer Advocate Support for assistance by calling (800) 883-5910.
- If you have comments or suggestions about how we can provide better service to the taxpayers of California, send an email to the Taxpayer Advocate by visiting our website at www.ftb.ca.gov.
- You can also contact the Taxpayer Advocate by mail at the following address:

TAXPAYER ADVOCATE BUREAU
FRANCHISE TAX BOARD
PO BOX 157
RANCHO CORDOVA CA
95741-0157

For Additional Information:

Visit our website at www.ftb.ca.gov
Call us at (800) 852-5711

For General Information:

Visit www.taxes.ca.gov